Historic, Archive Document

Do not assume content reflects current scientific knowledge, policies, or practices.

HD1491
U5A1
2

SEND TO STACKS

EQUITY REDEMPTION PRACTICES OF AGRICULTURAL COOPERATIVES

U.S. DEPT. OF AGRICULTURE
NAT'L AGRIC. LIBRARY
RECEIVED

MAY 5 '77

PROCUREMENT SECTION
CURRENT SERIAL RECORDS

FCS RESEARCH REPORT 41

UNITED STATES DEPARTMENT OF AGRICULTURE

FARMER COOPERATIVE SERVICE

PREFACE

Farmer Cooperative Service made this study in response to the need for current basic intelligence about farmer cooperatives' equity redemption policies and practices. In addition to providing information about the status of cooperatives' equity redemption programs, the study discusses various criteria that cooperatives may use in making decisions about such programs.

The report seeks to answer such basic questions as:

1. To what extent are cooperatives using equity redemption programs?

2. How valid are commonly cited constraints inhibiting or influencing a redemption program?

3. Is there a rationale for an equity redemption program that accommodates the divergent capital needs of members and their cooperatives?

CONTENTS

FCS Research Report 41 April 1977

HIGHLIGHTS

When a cooperative member has plowed his last furrow as a farmer, he becomes an inactive member who may have a problem. Some of his equity may continue to help finance the cooperative's fixed and operating needs.

For the cooperative, this inactive member equity can represent between 10 and 48 percent of its allocated equities. To retire the equity without jeopardizing the association's financial structure is the cooperative's problem.

Of the cooperatives in a study by Farmer Cooperative Service, 71 percent had some sort of program for redeeming patron equities in 1974. And on the average, cooperatives were redeeming equities at a rate equivalent to 8 percent of their 1974 net margins.

Most prevalent program is the "first in, first out revolving program," in which the older equities are redeemed first. Of cooperatives having a systematic redemption program, 90 percent used this "first in..." plan.

Despite these positive ratios, many former active cooperative members can contend that only those who are using the cooperative should be financing its operations. Cooperatives cited several obstacles, including:

A cooperative's poor financial condition; competitive reasons; pressure from younger members to place a higher priority on cash patronage refunds, and a lower priority on an equity redemption program; or restrictions from a cooperative's lending institutions.

The study found that these arguments had little merit. The most cogent factor influencing the presence or absence of any sort of equity redemption program was sheer size of total assets. The larger the size of the cooperative the greater the probability of its carrying out a redemption program.

The authors conclude that "some sort of program can be adopted by practically all cooperatives if there exists a determination to plan and budget for equity redemption."

They urge that "cooperatives through voluntary initiatives should be able to demonstrate that they have taken steps to implement a basic cooperative philosophy—namely, those who patronize their cooperatives should bear the primary financing responsibility; those who have effectively terminated their patronage should be relieved of their financing responsibilities."

EQUITY REDEMPTION PRACTICES OF AGRICULTURAL COOPERATIVES

Phillip F. Brown and David Volkin
Agricultural Economists

PRINCIPLES AND PROBLEMS

A generally accepted principle of cooperative financing holds that farmer cooperatives should be financed primarily by patrons currently using their services. A problem arises if one accepts the corollary premise that patrons no longer using the services should be relieved of their financing responsibilities. Many cooperatives have adopted some sort of program to retire equities under a systematic redemption program. Others retire equities held by estates, hardship cases, retirees, nonresidents, and the like. These are voluntary programs initiated at the discretion of a board of directors.

Where such redemption programs are not in effect, former member-patrons seek some sort of remedy. They write to their elected officials, both at the State and Federal level, seeking assistance or urging possible legislative remedies. Some equity holders have sought relief from the courts only to learn that redemption of equities is a discretionary matter falling within the fiduciary and trustee responsibilities of the board of directors.

Such pressures may culminate in legislative attempts to force equity retirement. An example of such an attempt was a proposal in Congress to include a provision in the Revenue Act of 1969 that would increase the cash portion of patronage refunds from 20 to 50 percent, phased over a 10-year period, and to require redemption of the noncash portion at not less than 15 years from the date of their issuance.[1]

[1]See Dr. Michael L. Cook's paper, "Increased Institutional Pressure for Mandatory Equity Redemption in Farmer Cooperatives," in the Fall 1976 issue of *The Cooperative Accountant* for a more complete analysis of the trends, nature and scope of the pressures on cooperatives' equity redemption policies.

On the other side of the coin, the cooperative corporate entity needs capital to finance the growth in scope and volume of services members demand. Thus, the dilemma exists between a cooperative's capital requirements and current members' own farm capital requirements.

The problem is exacerbated if a local cooperative's equity redemption policy is out of phase with its regional cooperative's redemption policies. Lending institutions also influence a cooperative's equity redemption policy because of the lenders' concern about the impact of such policy on a cooperative's loan repayment ability.

Elements and Methods of This Study

This study grouped cooperatives according to their membership structure to reflect the study's orientation toward equity holders. Members in centralized cooperatives were entirely or primarily individuals, although some cooperatives in this group had a number of association members. Cooperative members and patrons generally think of the centralized cooperative as their local cooperative. Federated cooperatives had other cooperatives as their sole or primary members. Within these two membership groups, 13 types of marketing cooperatives,[2] farm supply cooperatives, and a group of related service cooperatives were identified. A sample of cooperatives was drawn from each of the larger groups, within the total population of cooperatives listed with Farmer Cooperative Service. All other cooperatives were chosen in a group too small to sample reliably. These cooperatives were mailed a carefully developed questionnaire. Reminder letters went to those not responding within a reasonable period. After a check of several balance sheet ratios from respondents indicated wide variance within five commodity marketing groups, a larger sample from these groups was taken. Usable responses provided an overall sample constituting 13 percent of the total population. Variance estimates indicate that data from the sampled groups is representative of those groups. A computer compiled results and in some cases tested for significant differences in the data.

[2]The 13 groups included cooperatives marketing dry edible beans and peas, cotton and cotton products, dairy products, fruits and vegetables, grain and soybeans including processed products, livestock and livestock products, nuts, poultry and poultry products, rice, sugar products, tobacco, wool and mohair, and other miscellaneous marketing cooperatives.

Survey data are primarily for fiscal years ending in 1974 and, in some cases, in 1975, depending on the availability of the most recent financial data. Survey findings for each commodity group were applied to the total number of cooperatives reported to be in that group by FCS for 1973-74. Therefore statements about centralized marketing cooperatives and all cooperatives reflect the appropriate weight each type of cooperative gives to the total.

For purposes of this study we classified cooperatives' equity redemption programs into two broad categories: systematic and special.

We defined a *systematic* program for retiring equities as one that is carried out under a definite plan with a fair degree of regularity and where the fairly predictable financial requirements could be taken into account in a cooperative's financial budgeting process.

The mail questionnaire used in the study illustrated several types of programs that could be characterized as "systematic." They are listed as follows:

1. A first in, first out revolving program.
2. Redemption of a certain percent of all outstanding equities regardless of the year in which they were issued.
3. Redemption of equities as an integral part of a base capital plan.[3]

We defined a *special* equity redemption program as one that was not carried out with predictable regularity or one that involved predictable amounts redeemed in response to certain circumstances. For example, we defined a special program as one under which cooperatives redeemed equities held by:

1. Estates.
2. Patrons who achieved a certain age.
3. Persons no longer farming.
4. Persons claiming certain hardship situations.
5. Persons who simply requested redemption of their equities on an "on call" basis.

---

[3]Equity capital, regardless of the labels applied or categories into which it is placed by a cooperative, may be called the capital base provided by member-patrons. This capital base, determined to be required by the cooperative, is contributed by active member-patrons and may also be redeemed to them and former patrons following a prescribed plan tied to their participation over a period of time. Thus, the name "base capital plan."

FREQUENCY AND TYPES OF EQUITY REDEMPTION PROGRAMS

Table 1 summarizes the percent distribution of programs by basic membership and functional categories.

Seventy-one percent of all farmer cooperatives in this country have some sort of program for redeeming equities they have issued to their patrons. The remaining 29 percent have no program. The centralized cooperatives as a group maintain the 71-29 distribution. Within this group, however, the farm supply cooperatives share the highest percent—85 percent—of cooperatives with some sort of redemption program; the centralized related service cooperatives with 39 percent have the lowest percent. Federated cooperatives—as a group—show slightly less—65 percent—of their group with some sort of redemption program. A later section of this report discusses the importance to its member locals of a federated cooperative's equity redemption program.

Thirty-two percent of all farmer cooperatives carry out a *systematic* program for redeeming equities. Within this group 37 percent carry out a systematic program exclusively; the remaining 63 percent also redeem equities for special purposes.

A higher percent of the federated cooperatives have systematic redemption programs than do the centralized cooperatives: 53 percent compared with 32 percent.

Within the functional groups, 34 percent of the centralized marketing cooperatives and 31 percent of the farm supply cooperatives carried out a systematic redemption program, compared with 17 percent of the related service cooperatives.

Because the presence or absence of an equity redemption program has an immediate pocketbook interest to direct membership (centralized) cooperatives, much of the discussion in this report will focus on centralized cooperatives. We note, for example, that the so-called "no program" centralized group makes up 29 percent of the cooperatives but has a slightly lower proportion—26 percent—of members (table 2). Therefore, one out of every four members belongs to cooperatives that have no programs.

This situation, however, varies widely from one type of cooperative to another. For example, 15 percent of the centralized farm supply cooperatives have no equity redemption program.

Table 1—Equity redemption programs used by cooperatives, by membership and function

Type of cooperative	Systematic only	Special only	Both systematic and special	All program	No program	All cooperatives
			Percent			
Federated:						
Marketing	39	8	14	61	39	100
Farm supply	36	20	12	68	32	100
Related service	50	6	13	69	31	100
Total federated	40	12	13	65	35	100
Centralized:						
Marketing	17	30	17	64	36	100
Farm supply	3	54	28	85	15	100
Related service	6	22	11	39	61	100
Total centralized	12	39	20	71	29	100
All cooperatives	12	39	20	71	29	100

Table 2—Centralized cooperatives with and without equity redemption programs

Type of cooperative	Proportion of cooperatives with—			Proportion of membership in co-op with—		
	Redemption program	No redemption program	Total	Redemption program	No redemption program	Total
			Percent			
Marketing:						
Bean and pea	100	—	100	100	—	100
Cotton	68	32	100	90	10	100
Dairy	71	29	100	89	11	100
Fruit and vegetable	73	27	100	52	48	100
Grain	86	14	100	93	7	100
Livestock	11	89	100	61	39	100
Nut	67	33	100	27	73	100
Poultry	74	26	100	99	1	100
Rice	73	27	100	87	13	100
Sugar	44	56	100	88	12	100
Tobacco	46	54	100	58	42	100
Wool	6	94	100	48	52	100
Miscellaneous	54	46	100	71	29	100
Total marketing	64	36	100	78	22	100
Farm supply	85	15	100	69	31	100
Related service	39	61	100	29	71	100
Total centralized	71	29	100	74	26	100

But this 15 percent group includes 31 percent of farm supply cooperative members.

The centralized grain marketing cooperatives are an important group of cooperatives serving farmers. Only 14 percent of these cooperatives have no program for redeeming equities. And that group of "no program" cooperatives includes only 7 percent of the total members in centralized grain cooperatives.

Twenty-nine percent of the centralized dairy marketing cooperatives have no equity redemption program. But only 11 percent of the total number of members of such cooperatives belong to the "no program" group. Cotton cooperatives demonstrate the same relationships. That is, although 32 percent of such cooperatives have no program, only 10 percent of total members in cotton cooperatives belong to such "no program" cooperatives.

The significance of such relationships in the so-called "important" cooperatives lies in the member as well as public relations aspects. To illustrate, if in some types of cooperatives 90 percent of the members belong to cooperatives with some type of program, the chances for grousing and complaining about the lack of such programs are probably less than in situations in other types of cooperatives where 30, 40, 50 or a higher percent of members belong to cooperatives that have no program.

Systematic Programs

By far, the most prevalent form of systematic program used is the first in, first out revolving program. Ninety percent of the cooperatives that have a systematic program use a first in, first out program (table 3). Seven percent of all cooperatives redeem a percent of all outstanding equities regardless of the year of their issuance, and in third place are 2 percent of cooperatives redeeming through a base capital plan. The conventional first in, first out revolving plan was not as overwhelming in its usage by federated cooperatives as in the centralized group. For example, 73 percent of the federated cooperatives used the first in, first out type of redemption program, compared with 90 percent of the centralized cooperatives. Also 15 percent of the federated cooperatives used the base capital plan compared with 2 percent of the centralized cooperatives.

Table 4 compares the length of first in, first out revolving periods used by cooperatives that employ only this program with

Table 3—Systematic programs used by cooperatives with such programs

Type of cooperative	First in, first out revolving plan	Percentage of all equities	Base capital plan	Other	Total
			Percent		
Federated:					
Marketing	84	5	11	—	100
Farm supply	50	8	25	11	100
Related service	80	10	10	—	100
All federated	73	7	15	5	100
Centralized:					
Marketing	90	5	3	2	100
Farm supply	90	10	—	—	100
Related service	100	—	—	—	100
All centralized	90	7	2	1	100
All cooperatives	90	7	2	1	100

Table 4—Revolving periods of cooperatives using first in, first out revolving plan

Type of cooperative	Revolving plan
	Years
Revolving plan exclusively:	
Federated—all	8.5
Centralized	
Marketing	8.3
Farm supply	15.0
Related service	21.0
Total centralized	9.1
All co-ops using revolving plan exclusively	9.1
Revolving plan plus special programs:	
Federated—all	13.0
Centralized	
Marketing	11.1
Farm supply	11.8
Related service	3.0
Total centralized	9.1
All co-ops using revolving plan plus special program	11.4
All co-ops using revolving plan:	
Federated—all	9.6
Centralized	
Marketing	9.7
Farm supply	12.1
Related service	9.3
Total centralized	10.5
All co-ops	10.5

cooperatives that supplement their first in, first out program with special programs. On the average, cooperatives that carry out only one program redeem equities with an 9-year lag between issuance and redemption; those that use supplemental programs have an 11-year lag period. The average length of revolving periods for all cooperatives was 10.5 years.

Some idea of the relative magnitude of the amounts disbursed by cooperatives for redemption of outstanding equities is portrayed in table 5. On the average, cooperatives redeemed equities in an amount equivalent to 7.9 percent of their 1974 net margins. Those cooperatives that only carried out a systematic program disbursed an amount equivalent to about 7 percent of their net margins. Understandably, those cooperatives that redeemed equities under additional programs disbursed relatively greater amounts—9 percent of their net margins.

Table 5—Relationship of equity redemptions to net margins

Type of cooperative	Ratio of dollars redeemed to 1974 net margins
	Percent
Systematic co-ops exclusively	
Federated	12.3
Centralized	5.9
All co-ops with systematic plan only	6.7
Systematic co-ops with special redemption program	
Federated	4.5
Centralized	9.7
All co-ops using multiple programs	9.4
All co-ops with systematic programs	
Federated	10.1
Centralized	7.6
Total	7.9

Special Programs

By far the most popular type of special redemption programs carried out by centralized cooperatives are those designed to redeem equities held by estates. Fifty-four percent of all special programs are estate redemption programs (table 6). Ranked second in importance are those special programs designed to redeem equities held by patrons no longer farming. Nineteen percent of such special programs are established for that purpose. Table 6 shows the ranking of other special programs.

A semi-facetious remark often voiced is that an equity holder has to die before his equities are redeemed. Literally, this would apply only to those centralized cooperatives that used only one special equity redemption program—the redemption of equities held by estates. Table 7 provides some insight into this hypothesis by summarizing the most frequently used redemption programs. Table 7 also provides more detailed analysis of the multiple programs carried out by cooperatives that use only special programs. Only 14 percent of all centralized cooperatives fall in the category of solely using an estate redemption program. These are the cooperatives that have only one program—the estate redemption program—in contrast to those cooperatives who either have no program, have more than one program, or that have one program for other than estate redemption.

Only 15 percent of all centralized cooperatives use a special

Table 6—Special redemption programs most frequently used by centralized cooperatives that use only special programs, by function

Special redemption program	Type of cooperative			
	Marketing	Farm supply	Related service	All special program cooperatives
			Percent	
Estates	57	51	50	54
No longer farming	24	13	30	19
Retirement age	10	10	—	10
On call	5	13	10	9
Hardship situation	2	5	—	3
Other	2	8	10	5
Total	100	100	100	100

Table 7—Percentage distribution of equity redemption programs used by centralized cooperatives

Redemption program	Proportion of cooperatives using a plan	
	Percent	
Systematic programs only	12	
Special programs only:		
Estate redemption only	14	
Other bases for redemption	25	
One special program other than an estate redemption program		6
Two special programs		12
Three special programs		6
Four special programs		1
Total		25
Both systematic and special programs	21	
No redemption program	28	
Total	100	

redemption program designed to take into account the ages—presumably retirement age—of their equity holders. Table 8 indicates that about half of the cooperatives using age as a qualification designate 65 years of age or under as the qualifying age. Thirty-nine percent use ages between 66 and 75; and 12 percent require a patron to be 76 years or older. Only dairy, grain and farm supply cooperatives used age redemption programs.

Table 8—Retirement age groups for centralized cooperatives using age as a requirement for equity redemption

Retirement age groups	Percent
65 years	49
66–70 years	8
71–75 years	31
76–80 years	10
81 and over	2
Total	100

OBSTACLES TO REDEMPTION PROGRAMS

"No program" respondents generally cited one or more reasons for not carrying out any sort of redemption program. For example, they cited their organization's poor financial condition. Or they noted that, because of competitive reasons or pressures exerted by young farmers, their cooperatives placed a greater priority on high cash patronage refunds than on an equity redemption program. Or, they cited restrictions placed on their organizations by a lending institution. This section examines the status of cooperative redemption programs as they relate to these various constraints.

Working Capital Position

One quantifiable indication of a cooperative's financial health is its working capital position. We use the current ratio (current assets divided by current liabilities) as one measure of financial health. For our purposes we classified cooperatives with current ratios ranging from 1.5 and less as having a "poor" financial condition; 1.6 to 2.0 as "good;" and 2.1 and over as "excellent."

A recapitulation of data presented in table 9 indicates that 41 percent of centralized cooperatives with some type of redemption program had a poor financial condition, 21 percent were in good health, and 37 percent had an excellent financial condition.

Table 9—Centralized cooperatives' financial condition, as measured by current ratio—current assets/liabilities ratio

Type of cooperative	Financial condition: Poor 1.5 and less	Good 1.6–2.0	Excellent 2.1 and over
		Percent	
Marketing:			
Program	55	18	27
No program	73	9	18
Farm supply:			
Program	24	25	51
No program	60	10	30
Service:			
Program	29	14	57
No program	27	—	73
All:			
Program	41	21	37
No program	69	8	23

Sixty-nine percent of the cooperatives with no program were classified as being in poor financial condition: 8 percent were in good shape; and 23 percent had an excellent financial condition.

There was some—but not compelling—difference between the financial health of so-called "program" and "no program" cooperatives in the marketing group. Eighteen percentage points separated the "program" cooperatives classified as being in poor financial condition from the "no program" cooperatives with poor financial condition. A sharper contrast is shown in the farm supply group where 60 percent of the cooperatives with no program are in poor financial condition, whereas only 24 percent of farm supply cooperatives with some sort of redemption program are in poor financial condition.

The apparent poorer current ratio of cooperatives without redemption programs was tested for significant differences from the ratio of cooperatives using special redemption programs. The differences in their ratios were not significant, indicating that the presence or absence of a special program was not apparently determined by their current financial condition.

Significance of Per-Unit Capital Retains

One possible explanation of the ability of all marketing cooperatives—regardless of their financial condition—to carry out a redemption program is indicated in table 10. Twenty-three percent of marketing cooperatives that carried out some sort of redemption program acquired capital by per-unit capital retains, whereas only 4 percent of the "no program" marketing cooper-

Table 10—Centralized marketing cooperatives acquiring capital through per unit capital retains

Type of marketing cooperative	Proportion of cooperatives using per unit capital retains	
	Yes	No
	Percent	
Program cooperatives:		
Systematic only	41	56
Special program only	5	95
Both systematic and special	21	79
Total program cooperatives	23	77
No program cooperatives	4	96

atives used per-unit capital retains as a means of acquiring capital. The ability to acquire capital through per-unit capital retains does provide an assured means of obtaining funds that may be used to redeem outstanding equities. Under such circumstances equity redemption might be made without regard to the impacts on an association's long-term financial well-being.

Net Worth/Total Assets Ratio

Another measure of financial strength is the ratio of net worth to total assets. The higher the ratio, the stronger the financial condition. Table 11 provides some insight into the financial strength of "program" and "no program" cooperatives by arbitrarily assigning "poor," "fair," "good," and "excellent" descriptive terms to cooperatives whose net worth/total assets ratios fall within the following ranges:

Net worth/total assets (Percent)	*Financial strength*
0 - 15	poor
16 - 25	fair
26 - 50	good
over 50	excellent

How do the "program" and "no program" cooperatives compare? Nearly the same proportion of "program" and "no program" cooperatives, 64 and 66 percent respectively, were in excellent financial health. In the other categories, differences also were rather small. Only 2 percent of the "program" cooperatives were classified as being in poor financial condition. Eight percent of the "no program" cooperatives were in poor shape. Four percent of the "program" and 6 percent of the "no program cooperatives were classified as being in "fair" financial condition and 30 percent of the "program" compared with 20 percent of the "no program" cooperatives were classified as being in good financial condition. Overall, we reach a conclusion that, based on a net worth/total assets measure, the "no program" cooperatives may tend slightly toward being in worse financial shape than the program cooperatives, but it is not a strong meaningful conclusion. Stated more bluntly, the argument put forth that "no program" cooperatives are generally in poor financial condition is questionable.

Table 11—Centralized cooperatives' financial condition, as measured by net worth/total assets ratio

Type of cooperative	Poor (0–15%)	Fair (16–25%)	Good (26–50%)	Excellent (Over 51%)
			Percent	
Marketing:				
Program	1	6	32	61
No program	8	5	13	74
Farm supply:				
Program	2	2	27	69
No program	10	10	50	30
Related service:				
Program	—	—	—	100
No program	—	—	9	91
All centralized cooperatives:				
Program	2	4	30	64
No program	8	6	20	66

Debt/Equity Ratio

Some cooperatives have cited debt service requirements or constraints a lending agency places on a cooperative as primary reasons for their inability to carry out an equity redemption program.

Table 12 shows a percent distribution of centralized cooperatives based on their term debt/net worth ratios. Sixty percent of the cooperatives that had no equity redemption program also had no term debt. This compares with 30 percent of the cooperatives that had some sort of program that also had no term debt. As a matter of fact, 59 percent of the "program" cooperatives and 27 percent of the "no program" cooperatives had a term debt/net worth ratio of less than 50 percent.

In other words, as high a percent of "no program" cooperatives had the minimal debt service obligations as did those cooperatives that do carry out an equity redemption program.

What all this seems to say is that debt service obligations are not unique to "no program" cooperatives. The 70 percent of all cooperatives that had some term debt in their capital structure had also found a way to carry out some sort of equity redemption program.

Cash Patronage Refund Policies

Table 13 groups the various types of program and "no program" cooperatives according to their cash patronage refund practices. These practices vary from one extreme of paying no cash patronage refunds to the other extreme of paying 100 percent cash patronage refunds. Our findings indicate that 8 percent of the "program" cooperatives paid no cash patronage refunds; 65 percent of the "no program" cooperatives paid no cash patronage refunds. At the other end of the spectrum, 12 percent of the "program" cooperatives paid more than 60 percent cash patronage refunds; 10 percent of the "no program" cooperatives paid more than 60 percent of their patronage refunds in the form of cash.

These data refute the notion that "no program" cooperatives: a) channel their funds toward current patrons rather than toward the redemption of outstanding equities, and b) emphasize relatively high cash patronage refunds.

Table 12—Centralized cooperatives' financial condition, as measured by term debt/net worth ratio

Type of cooperative	No term debt		1–49%		50–99%		100–199%		Over 200%	
	With program	No program	With program	No program	With program	No program	With program	No program	With program	No program
	Percent									
Marketing	33	69	54	23	8	3	3	2	2	3
Farm supply	24	30	67	40	5	10	4	10	—	10
Related service	86	36	14	45	—	9	—	9	—	—
All cooperatives	30	60	59	27	7	5	3	4	1	4

Table 13—Cash patronage refunds paid in 1974 by centralized cooperatives

Type of cooperative	Distribution of cooperatives by cash refund of—				
	None	20–29%	30–39%	40–60%	Over 60%
	Percent				
Marketing:					
With redemption program	13	52	12	11	12
No program	70	17	4	1	8
Farm supply:					
With redemption program	—	53	13	21	13
No program	40	40	—	—	20
Related service:					
With redemption program	43	14	14	29	—
No program	91	9	—	—	—
All cooperatives:					
With redemption program	8	52	12	16	12
No program	65	21	3	1	10

Other Relationships

All types of cooperatives with redemption programs showed no consistent relationship between the progress or status of their programs and certain measures of funds available for redemption purposes. Specifically, no correlation was found to suggest that:

1. The current ratio held any relationship to the number of years over which cooperatives revolved equity.
2. The proportion of the patronage refunds retained showed any relationship to the number of years over which cooperatives revolved equity.
3. The proportion of patronage refunds retained showed any relationship to the proportion of allocated equity held by inactive members.

Size

The preceding discussion indicates that "no program" cooperatives generally were not in any worse financial condition than "program" cooperatives and that there is little basis for "no program" cooperatives to contend that they stress cash patronage refunds as an alternative to carrying out a redemption program. The factor that seems to have a higher correlation to the carrying out of some sort of redemption program is sheer size as measured by total assets.

Table 14 shows sharp contrasts between the size of "program" and "no program" cooperatives. For example, 46 percent of cooperatives with a redemption program had total assets of more than $1 million and only 4 percent of this group had total assets of less than $100,000. On the other hand, only 14 percent of the "no program" cooperatives had total assets of more than $1 million and, at the other end of the spectrum, 52 percent of this group had total assets of less than $100,000. As a matter of fact, 44 percent of "no program" cooperatives had less than $26,000 of total assets.

One explanation of the ability of larger cooperatives to carry out some sort of program is speculative: The larger cooperatives simply have a greater cash flow at any given time of the year. Thus, regardless of their basic financial ability the larger cooperatives can come up with the funds to redeem equities; the smaller cooperatives cannot.

Table 14—Total asset groups of centralized cooperatives

Type of cooperative	Percentage of cooperatives with assets of—					
	$26,000 and under	$26,001–$100,000	$100,001–$500,000	$500,001–$1 mil.	$1 mil.–$100 mil.	Over $100 mil.
			Percent			
Marketing:						
With program	1	3	17	21	57	1
No program	54	7	16	8	15	—
Farm supply:						
With program	—	4	33	33	31	—
No program	10	10	40	30	10	—
Related service:						
With program	43	28	—	29	—	—
No program	17	33	50	—	—	—
All centralized cooperatives:						
With program	1	3	24	26	45	1
No program	44	8	22	12	14	—

FINANCING BY INACTIVE MEMBERS

During the 20 years 1954-74, farm population dropped 51 percent and the number of farm operators decreased about 46 percent. This type of adverse structural change in agriculture continually creates inactive members for cooperatives. An annual average drop of about 137,000 in farm operators, for example, is a substantial drop in the field of potential cooperative membership.

A basic premise undergirding the financing of a cooperative's operations is the proposition that those who use the cooperative's services should finance it. The corollary premise is a proposition stating that those who do not use the cooperative's services should be relieved of their financing responsibilities. For both philosophical and practical reasons, it may not be feasible or it may not be acceptable to a cooperative to undertake a program to reduce the financing responsibilities of those who, for whatever reason, no longer use a cooperative's services.

In any event, over time, a cooperative's capital structure eventually can include substantial funds supplied by those who no longer use the cooperative. Thus, our study addressed itself to the questions: To what extent is the net worth of cooperatives held by persons no longer using the cooperative? Can we get a "handle" on the number of equity holders who are "active" patrons—that is, those who used the cooperative's services in the immediately preceding 3 years, compared with those equity holders who no longer use the cooperative?

Sixty-nine percent of all centralized cooperatives have some allocated net worth outstanding issued to persons no longer patronizing their cooperatives (table 15). However, 80 percent of all centralized cooperatives that carry out some sort of redemption program have inactive equity holders, compared with 40 percent of cooperatives that have no program. Thus it appears that more of the cooperatives that have the problem of inactive equity holders also are carrying out programs to improve that situation.

Those cooperatives that have no program whatsoever for redeeming equities had 37 percent of their equity holders inactive (table 16). This compares with 57 percent of the equity holders of cooperatives that have some sort of equity redemption program for those who are inactive. Inactive equity holders possess 22 percent of the allocated equities issued by both cooperatives with some sort of redemption program and those with no program. By

Table 15—Active and inactive equity holders of centralized cooperatives

Type of cooperative	Cooperatives with— Only active equity holders	Inactive equity holders	Total
		Percent	
Marketing:			
With program	17	83	100
No program	68	32	100
Farm supply:			
With program	24	76	100
No program	30	70	100
Related service:			
With program	40	60	100
No program	64	36	100
All centralized cooperatives:			
With program	20	80	100
No program	60	40	100
Total all cooperatives	31	69	100

functional groups 31, 38, and 48 percent of all outstanding allocated equities are held by inactive ex-patrons of the "no program" marketing, farm supply and related service cooperatives, respectively. On the other hand, only 10 percent of the outstanding equities of farm supply cooperatives that carry out some sort of equity redemption program are held by inactive equity holders.

In summary, farmer cooperatives—both those that are carrying out some sort of redemption program and those that are not—have a substantial amount of allocated capital outstanding held by a substantial number of inactive patrons. The pressures for change are apparent in this situation.

Because the so-called "program" cooperatives—especially the farm supply cooperatives—are doing something about such pressures, we took a closer look at certain relatively important marketing cooperatives that have no redemption program (table 17). These included the cotton, grain, dairy and fruit and vegetable marketing associations.

For example, 78 percent of the equity holders were inactive in the centralized dairy cooperatives without redemption programs. That group holds 61 percent of outstanding equities. Sixty-five percent of the "no program" cotton marketing cooperatives' equity holders are no longer patronizing their cooperatives. This inactive group holds 30 percent of outstanding equities. Only one-third of fruit and vegetable marketing cooperatives equity holders

Table 16—Equity holders and relative share of equities in cooperatives with and without redemption programs that had inactive equity holders

Type of cooperative	Equity holders		Allocated equities held by	
	Active	Inactive	Active	Inactive
	Percent			
No program cooperatives:				
Marketing	51	49	69	31
Farm supply	76	24	62	38
Related service	49	51	52	48
All no program cooperatives	63	37	68	32
Program cooperatives:				
Marketing	33	67	72	28
Farm supply	72	28	90	10
Related service	39	61	58	42
All program cooperatives	43	57	78	22

Table 17—No program marketing cooperatives with inactive equity holders and share of equity held by inactive equity holders

Type of no program marketing cooperatives	Proportion of cooperatives with inactive holders	Proportion of equity holders as—		Proportion of al'ocated equities held by—	
		Active members	Inactive members	Active members	Inactive members
	Percent				
Cotton	24	35	65	70	30
Dairy	11	22	78	39	61
Fruit and vegetable	10	67	33	94	6
Grain	10	53	47	66	34

are no longer patrons. That group holds only 6 percent of the outstanding allocated equities. Forty-seven percent of grain cooperative equity holders are inactive. They hold one-third of the outstanding allocated equities.

The preceding discussion makes the point that both "program" and "no program" centralized cooperatives have a substantial portion of their allocated capital structure owned by a substantial number of persons no longer patronizing cooperatives. These funds obviously are used in a cooperative's operations. To the extent that such funds are used for purposes traditionally expected of cooperatives, i.e., for services benefiting active producers on an at-cost basis, then it would appear that management can justify, at least in part, its assigning a low priority to the matter of equity redemption.

On the other hand, 65 percent of "program" cooperatives and 46 percent of "no program" cooperatives that had inactive equity holders engaged in profit-making activities that gave rise to tax-paid unallocated reserves (table 18). Collectively the increase in unallocated net worth from 1974 operations was 14 percent of the value of inactive holders' equity. Thus we see a picture of cooperatives whose capital structure includes funds provided by persons no longer patronizing their cooperatives whose management is using such funds, in part, for profit-making activities. We recognize, however, that some cooperatives' unallocated reserves

Table 18—Centralized cooperatives with both inactive equity holders and additions to unallocated net worth in 1974

Type of cooperative	Inactive equity holder cooperatives with additions to unallocated net worth	Unallocated net worth increase in 1974 as percentage of inactive member equity
	Percent	
No program cooperatives:		
Marketing	47	11
Farm supply	43	14
Related service	50	12
All no program	46	12
Program cooperatives:		
Marketing	53	10
Farm supply	83	36
Related service	67	9
All program	65	14
All cooperatives	62	14

originate from all members or all patrons, especially where State statutes require a specified percent of annual net margins to be placed in capital reserves. Nevertheless, the frustration expressed by former patrons—especially expressed by those holding equities in cooperatives that have no equity redemption program—is understandable.

It is generally from inactive equity holders that complaints are brought to the courts or made to public policymakers for some sort of redress of their grievance against the cooperative whose equities they hold. The findings in this report suggest that, although there may be some merit in arguments advanced by "no program" cooperatives to the effect that their financial condition, cash patronage refund policies, or debt service requirements place constraints on their ability to carry out some sort of equity redemption program, at the same time cooperatives that do carry out a redemption program generally confront the same financial problems. The findings also indicate that a fairly substantial amount of allocated net worth is provided by persons who for one reason or another are no longer using their cooperative's services. And to the extent that such cooperatives are deferring redemption of such equities, then to that extent current patrons are not assuming their full financing responsibilities.

Efforts to "force" such redemptions through various court actions or through the Federal and State legislative routes are symptomatic of a problem that reinforces the need for voluntary action.

The following section provides a modest yet logical approach that cooperatives may want to consider in meeting the problem of equity redemption.

An Equity Redemption Rationale And Proposal

From the individual patron's point of view, the desire for redemption of equities in a cooperative has a great deal of merit when he evolves into a cycle of reduced and eventually complete nonuse of the cooperative's services. By and large, his investment in the cooperative was for the purpose of enhancing his farm income; not for a return on his investment as such. Thus the patron's position is essentially this: "I accept my financing responsibilities proportional to my use of the cooperative's services. When I terminate my use of the cooperative, I not only want to be relieved of further financing responsibilities but also I

would like the cooperative to return my investment. Let others who use the cooperative's services take over the financing responsibilities."

On the other hand, from the cooperative entity's point of view, redemption of equities obviously results in a reduction in working capital that can have serious consequences. The cooperative as an entity can "argue" that it does have a life of its own and that its current and future financial needs should have a priority above the individual financial needs of nonusing patrons.

For this reason, a conventional bylaw provision generally vests discretionary authority in the board of directors in matters of equity redemption. In this situation of conflicting priorities, the potential for frustration, perhaps even explosive consequences, can be avoided if an accommodation to the needs of both nonusing patrons and of the cooperative is designed and implemented.

For example, the cooperative's records should be maintained in such a way as to provide a documented basis for determining who is and is not using the cooperative's services. The equity held by nonusers can be translated through long-range planning efforts into amounts that can be budgeted for redemption just as are amounts budgeted for facility acquisitions. An ideal situation would anticipate equity contributions from current patrons completely replacing equities redeemed to past patrons. Marketing cooperatives that use per-unit capital retains to acquire capital can, under some circumstances, acquire and redeem almost on a dollar-for-dollar revolving door basis. But other demands on working capital may tend to absorb current patrons' capital contributions for purposes over and above the specific requirements of equity redemption.

The "accommodation" might be reached when one philosophizes that elements on the liabilities and net worth side of the balance sheet for the most part finance the whole mixed bag of assets on the other side of the balance sheet. For example, a cooperative that has a current ratio of 1.5 to 1 is financing part of its current assets with net worth. Thus, past patrons should understand that their request for redemption of their equities may require a liquidation of current assets that could result, for example, in a 1.3 to 1 current ratio which, in turn, could adversely affect the cooperative's ability to serve current patrons effectively. But if all patrons—both active and inactive—understand that their funds are not entirely tied up in current assets but also are par-

tially used to finance the fixed and "other" noncurrent assets, it may be possible for such patrons to recognize that there is another point of view to the whole matter of equity redemption.

To pursue this finance-oriented point of view to a logical type of recommendation, we are suggesting that redemption be made in a manner conforming somewhat to a cooperative's asset structure. That is, assuming that net worth is financing assets indiscriminately, therefore it is financing current, fixed and other assets proportional to their respective percentage mix. For example, if a typical array of assets are found to be in the following mix:

Current assets	60 percent
Fixed assets, net	35 percent
Other	5 percent

—then a patron requesting equity redemption ought to recognize that for every dollar he is holding the cooperative only has 60 cents in reasonably liquid position to meet his request. The other 40 cents is tied up in brick and mortar, investments in other cooperatives, and other nonliquid assets. Thus, our essential recommendation would gear equity redemption around a cooperative's ability to convert current assets into cash to meet such requests. Thus, in our example, for every $1 of equities to be redeemed, 60 cents would be paid in cash within 1 year of the request; and 40 cents would be paid in the form of a longer term type of obligation such as a 5-year interest paying debt instrument under the assumption that one expects earnings derived from operation of the nonliquid assets to pay off such debt paper.

Issues to be decided would focus on the question of when, for the purposes of equity redemption, a patron would be designated as no longer using the cooperative's services. Perhaps 3 successive years of nonuse might be an acceptable arbitrary timespan. Individual circumstances should govern this sort of determination.

Because this proposal is simply based on whether a patron is using or not using the cooperative's services, other bases for redemption, i.e., whether an equity holder is an estate, is of a certain age, or is undergoing certain hardships, are irrelevant and not considered as appropriate for the cooperative entity to be concerned about.

The foregoing discussion is based on an assumption that a

nonusing patron requests redemption of his equities. There are circumstances where nonusing patrons do not request redemption for reasons ranging from apathy and ignorance to a generous spirit known only to statesmen and philanthropists. Under such circumstances, a cooperative's management either may decide to "let sleeping dogs lie," or take a policy initiative. One initiative it may take is based on the premise that capital provided by a nonusing patron should be treated as dividend paying capital just as though it were originally bought and held by nonproducer investors in an ordinary business enterprise. Thus we would differentiate between capital provided to a cooperative to be used to enhance farm income as a result of services the cooperative provides and capital provided as an investment by nonusers who look for and expect a return on their capital investment as a reward for their investment risk.

Role of a Federated Cooperative In A Local's Equity Redemption Program

A federated cooperatives' equity redemption program can significantly affect a member local's cash flow situation. For example, if a federated cooperative redeems in cash nonqualified written notices of allocations issued in prior years to its member locals, such income can have a dramatic effect on local's current operating results. For example, such income might be the difference between a local's operating in the red or black in a particular year.

On the other hand, if a federated cooperative redeemed in cash previously issued qualified written notices of allocation, that welcomed bit of cash could in turn catalyze or trigger an equity redemption program by a local to its equity holders. A federated's equity redemption program may even have a multiplier effect on its member locals' redemption policies in the sense that a local might redeem some of its outstanding equities by an amount substantially greater than the proceeds it received from its federated regional.

From the federated cooperative's point of view, however, all the factors that affect a centralized local cooperative's ability to redeem its outstanding equities also affect a federated regional's ability to redeem its equities. The one obvious advantage that a federated cooperative has, however, is a greater cash flow

resulting from the seasonality and sheer volume of its financial and operational business transactions.

The plan followed by Farmland Industries is an excellent example of a federated cooperative that has assumed a leadership role in working with its member cooperatives in the development and implementation of the latters' equity redemption programs. Farmland initiated its program because its management realized that there was a good deal of substance to a local's complaint that it was unable to undertake any significant equity redemption program because a substantial amount of its funds were "tied up" in its investments in Farmland Industries. A brief summarization of the Farmland plan follows:

FARMLAND INDUSTRIES' OWNERSHIP RETIREMENT PROGRAM

Farmland participates in its member local cooperatives' equity retirement programs by redeeming in cash a pro rata portion of a local's equity in Farmland. Some important features of the Farmland program are:

1) The local must demonstrate that it has redeemed during the preceding calendar year equities held by estates or retired members 65 years of age or older.

2) Farmland's total annual redemptions under this program will be limited to an amount equivalent to 5 percent of Farmland's total patronage refunds for its previous fiscal year.

3) Equities submitted for redemption by locals must be the oldest common shares held by the locals.

The computation of the amount a local may request for equity redemption is illustrated in the following steps:

1) Ascertain the local's total investment in Farmland Industries in common and third preferred shares. This amount is determined as of date of local's fiscal year ending during last calendar year. Example . . . $172,000

2) Ascertain the local's total members' equities from audit dated (*as of date of local's fiscal year ending during last calendar year*) $1,125,700

3) Divide the figure on line (1) by the figure in line (2) to determine the percent of local's total equities derived from Farmland. Thus $172,000 divided by $1,125,700 equals .... 15 percent

4) Enter the total cash payments local made during last calendar year in redemption of equities held by estates and retired members over 65 years of age $19,145

5) Compute amount of payment requested from Farmland (line 4 multiplied by line 3) in redemption of oldest common stock certificates submitted to Farmland for cancellation. Fifteen percent of $19,145, or .... [4]$2,875

[4]Payment made to nearest $25.

CONCLUDING COMMENTS

With one lone exception, the respondents to our questionnaire reflected a lively interest and concern about the matter of equity redemption. There was little evidence of a purely arbitrary attitude. Rather, there were many expressions of pride in their programs from officials of many cooperatives that redeemed equities; and from many officials that had no programs came strong indication that equity redemption policies were being considered.

Our own view is that *some* sort of program can be adopted by practically all cooperatives if there exists a determination to plan and budget for equity redemption. Our findings indicate that the usual reasons for not carrying out a redemption program—poor financial condition, a demanding debt service obligation, a higher priority given to cash patronage refunds—have little merit. The old cliche—where there's a will, there's a way—aptly fits this situation.

Our findings also indicate that a substantial amount of cooperatives' equity capital financing is furnished by former patrons—both living and dead. The living complain, and public policymakers take note. The pressures for change exist. As these pressures mount, cooperatives through voluntary initiatives should be able to demonstrate that they have taken steps to implement a basic cooperative philosophy; namely, those who patronize their cooperative should bear the primary financing responsibility. Those who no longer patronize should be relieved of their financing responsibilities.

OTHER PUBLICATIONS

Legal Phases of Farmer Cooperatives. Morrison Neely. Information 100. 1976. 747 pp.

Handling Net Margins Under Federal Tax Laws. David Volkin and J. Warren Mather. Information 39, 1976. 6 pp.

Statistics of Farmer Cooperatives 1972-73, 1973-74, and 1974-75. Bruce Swanson and Jane H. Click. Research Report 39. 1977. 52 pp.

A Financial Profile of Farmer Cooperatives in the United States. Nelda Griffin. Research Report 23, 1972. 71 pp.

How Farm Marketing Cooperatives Return Savings to Patrons. Donald R. Davidson. Research Report 7. 1970. 81 pp.

How the Adjustable Revolving Fund Capital Plan Works. Nelda Griffin. General Report 111. 1963. 8 pp.

Farmer Cooperative Publications, Information 4. 1976. 41 pp.

For copies, write: Farmer Cooperative Service, U.S. Department of Agriculture, 500 12th St., S.W., Washington, D.C. 20250.

FARMER COOPERATIVE SERVICE
U.S. DEPARTMENT OF AGRICULTURE

Farmer Cooperative Service provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The Service (1) helps farmers and other rural residents obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs.

The Service publishes research and educational materials and issues *Farmer Cooperatives*. All programs and activities are conducted on a nondiscriminatory basis, without regard to race, creed, color, sex, or national origin.